Finance Canada

News Release

Immediate release

Ottawa, December 14, 1998
98-124

Statement by
The Honourable Paul Martin
Minister of Finance
on the bank merger proposals

Ottawa, Ontario
December 14, 1998

CHECK AGAINST DELIVERY

Ladies and gentlemen,

I am here today to announce the decision with respect to the proposed mergers of the Royal Bank of Canada and the Bank of Montreal, and of the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank.

The government has now received, and has had the opportunity to study, the findings of the Competition Bureau, the report of the Office of the Superintendent of Financial Institutions, as well as the recommendations of two parliamentary committees.

Since the first day the banks made the merger proposals public, we have stated that the litmus test for allowing or disallowing them had to be whether they are in the public interest.

Background

Parliament has given the Minister of Finance the responsibility to approve or disapprove such proposals.

This is because it recognized that banks are not like any other business.

They have great economic power and influence, not simply because of the assets they control or the loans they make, but because banks play a critical role in most economic aspects of the lives of individual Canadians and our businesses.

They take deposits from Canadians, safeguard their savings, and finance their purchases so that people can buy homes or cars, and businesses can meet their payrolls, buy inventory and expand their operations.

In short, a strong and efficient domestic banking sector is vital to Canada's economic success.

The decision to allow or disallow the mergers of such large financial institutions will have an important and direct impact on the security, welfare and prospects of every Canadian.

Governments have always strived to create and maintain an environment that would ensure the stability and prosperity of our financial institutions.

Far from being a straitjacket, government regulation has provided our banks fertile ground to grow and flourish, not only within our own borders but also around the world.

The result has been a healthy financial services sector that has provided a solid foundation on which to build our economy and society.

Our financial institutions provide a high level of quality services to businesses and consumers alike, in communities large and small, urban and rural, from one end of this country to the other.

The men and women who work in Canada's financial institutions are the people Canadians turn to for financial services and advice, and the success of each institution depends on them.

They can take pride in what they have achieved, and in what they do for their fellow Canadians.

The Forces of Change

As a government, we recognize that the national and international context in which the banks operate is undergoing rapid and profound change.

Globalization and technological innovation have vastly expanded the range of financial services available to businesses and consumers.

These services can now be provided faster and more easily across geographic boundaries.

These forces bring with them tremendous opportunities and formidable challenges.

For example, while our financial institutions can adapt technologies to better serve their existing clients, the accessibility of technology also provides opportunities for their competitors.

In addition, while globalization has allowed Canadian banks to better serve their Canadian clients' foreign operations and has opened up new market opportunities, it has also meant that foreign providers of financial services have been able to make inroads into the Canadian market.

It was in recognition of a changing environment that the government, in 1996, launched the Task Force on the Future of the Financial Services Sector, asking it to conduct a major review of the future of the industry.

That was well before the current merger proposals.

The report, which was released in September, outlined a comprehensive agenda for change in the financial sector.

Central to that agenda is how it can best serve the interests of Canadians and the communities where they live.

We are committed to building a framework that will ensure a dynamic and consumer-responsive financial services industry for the 21st century.

An industry that remains predominantly Canadian controlled because it is such an important component of a dynamic economy, and because Canadian control is the best way to ensure that our consumers and our businesses receive services that are tailored to Canadian needs.

On the issue of mergers, the task force report did not address the two specific proposals that we have before us today, and indeed it was not mandated to do so.

It did, however, conclude that mergers can be a legitimate business strategy.

This view has also been supported by the recommendations of two parliamentary committees.

However, all recommended that mergers should only be approved if, in the words of the task force, "markets remain competitive, there are no material safety and soundness concerns, and the transaction is in the public interest".

The government agrees.

We are committed to ensuring that communities large and small have access to quality services at an affordable price.

We are committed to ensuring that consumers and small businesses have the range of choice that they need.

We view issues such as access, service fees, technological innovation, employment and international competitiveness as priorities.

Maintaining Safety and Soundness

I now want to turn to the specific analysis and advice that I have received on the proposed mergers.

The first is from the Superintendent of Financial Institutions who has provided us with a number of background reports.

Company data and private information, by law, must remain confidential.

However, in order to be as open as possible, he has also provided us with a summary letter that I am making available today.

The Superintendent's letter does not rule out either merger for prudential reasons, but it does raise some important and legitimate issues about their potential impact on the overall financial system, and recommends that the government take these into consideration in formulating its decision.

Obviously, Canadians do not, and should not, worry about our banks – they are strong and financially sound.

Canadian banks can withstand financial pressures without the widespread difficulties that have occurred and are still occurring in a number of countries.

The international community regards our banks as among the most stable anywhere in the world.

That being said, in assessing the mergers, we must consider the impact that they would have in a potential future circumstance where one or more banks are not as strong or as sound as they should be.

On this, the report of the Superintendent makes it clear that, when a financial institution gets into trouble, it is vitally important that there be as many options as possible to work out its difficulties.

The Superintendent then goes on to point out that, and I quote:

"If these mergers were approved and one of the merged banks experienced serious problems … to make full use of certain options, changes to ownership, competition and other policies might be required."

End of quote.

Historically, in Canada, when a financial institution has faced difficulties, one possibility has always been to sell its operations to other stronger Canadian competitors.

However, after such a merger, a sale to a domestic firm could seriously reduce the level of competition within the Canadian sector.

If this were not acceptable, we could be faced with a situation where the only other option would be a sale to a foreign institution.

But, given the size of the banks that would result from these proposed mergers, such a sale of assets to a foreign institution would result in a substantial reduction in Canadian ownership and control.

Therefore, faced with a firm in financial difficulty, and with fewer large domestic institutions, we could find ourselves in a situation where we might have to put other fundamental policy objectives, such as the need for competition or Canadian control, into question in order to preserve our ability to address potential problems.

In other words, the sheer size of the institutions that would result from these mergers would constrain the alternatives available to regulators and to government.

We all agree that the essential task is to preserve public confidence in the financial system.

That confidence depends in part on having a range of possibilities open to handle "problem" institutions – and keeping these options open even when no problems are on the horizon.

Enhancing Competition

We have also received the conclusions of the Director of Investigation and Research of the Competition Bureau.

As we have said in the past, the Bureau's analysis is one of the cornerstones of our decision today because competition is key to many of the core issues, such as the quality, price and availability of financial services to Canadians.

In his letter, the Director states that, and I quote:

"For the purposes of its analysis, the Bureau examined the impact on competition of all banking services and determined that a detailed analysis was required for three major lines of business in which the banks are engaged: branch banking services to individuals and businesses, credit cards, and securities."

End of quote.

After a comprehensive review, the Director concludes that the mergers of the Canadian Imperial Bank of Commerce and the Toronto-Dominion Bank, and of the Royal Bank of Canada and the Bank of Montreal, as proposed, are likely to, and I quote:

"…lead to a substantial lessening or prevention of competition that would cause higher prices and lower levels of service and choice for several key banking services in Canada".

End of quote.

In short, and to give just one example, in the area of bank branching – the core of personal and small business banking in Canada – the Bureau found that, in the case of both mergers, there would be a negative impact on hundreds of communities, urban and rural.

The analysis provided to us by the Competition Bureau is thoroughly researched and very persuasive.

As promised, I am releasing the reports provided to us so that their full weight can be assessed by the public.

They address all the relevant competition concerns and the Director will be available later this afternoon to provide more details about his findings.

Limiting Concentration of Power

Now, allow me to turn from the precise issue of competition policy to the broader public interest which, as I have made clear from the beginning, must be a major cornerstone of our decision.

There is one particular concern on which I would like to expand.

It has to do with the concentration of economic power that would result from the mergers.

By any standard, Canada already has one of the most concentrated banking systems in the world.

Allowing the mergers would mean leaving decisions on credit allocation – which are so crucial to the efficient functioning of the economy – in the hands of even fewer, larger institutions, thereby raising serious concerns that go well beyond the issue of competition.

There is value in having more rather than less choice – a wider range of alternatives for bank financing, for credit advice, or for any variety of other services offered by the banks – to ensure that there is greater opportunity for more innovative ideas to flourish, for more entrepreneurial risk to be taken, and for more options to be explored in creating a productive economy.

Let me give you some examples of what I mean.

As most of you know, for small businesses, it is crucially important to have multiple opportunities to make the case for obtaining a loan.

The number of options is not only a matter of obtaining competitive rates, which flows from competition policy, it is a question of enhancing the chances of getting a loan at all.

Lending decisions often involve a subjective element.

We believe that small business is best served by having more bank lenders rather than fewer.

Finally, concentrating so much credit decision making in the hands of so few institutions also has implications from the standpoint of how well we manage the overall economy.

No single institution should be so large as to have a major influence on the overall availability of credit in the country.

If circumstances were to lead to large dominant institutions having to restrain lending, the resulting withdrawal of bank credit could lead to a "credit crunch", with adverse consequences on the economy as a whole.

One must ask the question therefore – does it make sense to further concentrate a very high level of economic power within an even smaller number of very large institutions?

Decision

As mentioned, the government has received and considered the reports of the MacKay Task Force and two parliamentary committees, as well as the findings of the Superintendent of Financial Institutions and of the Competition Bureau.

As a result, we are now in a position to make a decision.

I am announcing today that the bank mergers will not be allowed to proceed because they are not in the best interests of Canadians.

The mergers would lead to an unacceptable concentration of economic power in the hands of fewer, very large banks.

They would result in a significant reduction of competition.

And they would reduce the government's policy flexibility to address potential future prudential concerns.

This is a decision that reflects the government's commitment to ensuring strong competition in the financial services sector.

Moving Forward

Looking forward, our immediate priority is now to focus on establishing an appropriate policy framework for the financial sector for the 21st century.

Whereas the merger proponents wanted the mergers to be allowed in order to change the status quo, we believe the status quo must be changed before any merger can be considered.

That is why, just two weeks ago, we introduced legislation to allow insurance companies to demutualize.

It is why we will be introducing legislation shortly on foreign bank branching.

And it is why we will be moving quickly to respond to the recommendations set forth by the financial sector task force and the two parliamentary committees.

This will include putting in place a new review process to assess major bank merger proposals.

We will be setting out a new policy framework that:

- fosters jobs and economic growth;
- responds to the needs of consumers and small business;

- ensures the sector continues to be financially sound and secure;
- promotes competition by allowing for the entry of new players, both from across Canada and from abroad;
- enables the sector to be at the leading edge of technological innovation; and
- allows for strong Canadian institutions with a solid international presence.

In summary, the government will not consider any merger among major banks until the new policy framework is in place.

But even then, new proposals will first have to demonstrate, in the light of the circumstances of the day, that they do not unduly concentrate economic power, significantly reduce competition or restrict our flexibility to address prudential concerns.

And overall, they would have to be in the best interest of Canadians.

Thank you.